Financial Management Report as of DECEMBER 31, 2008

AT A GLANCE:

General Fund revenues ended behind last year by 1.1 percent.

2008 Sales tax revenue performance in the red (see page 5)

Development revenue down (see page 3)

Is there any good news? (See page 2 sidebar)

It's been (going to be) a bumpy ride (see pages 7-8)

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Summary of All Operating Funds: *Revenue*

- **General Fund** actual 2008 revenue ended **1.1 percent behind** last year largely due to disappointing sales tax revenue and a significant decline in building permit and planning fee revenue. A more detailed analysis of General Fund revenue can be found on page 3, and sales tax revenue performance can be found beginning on page 5.
- **Other General Government Funds** actual 2008 revenue ended **1.3 percent ahead** of last year due to higher internal rates, strong lodging tax and recreation revenue, and despite a 10 percent decline in motor vehicle fuel tax. Motor vehicle fuel tax performance improved the last quarter of the year as fuel prices dropped. This tax is collected as a flat rate per gallon and is distributed by the State based on population. Increased fuel costs that decrease consumption (fewer gallons sold) have a negative impact on this revenue.
- **Water Sewer Operating Fund** actual 2008 revenue ended **3.2 percent higher** than last year due primarily to water and sewer revenue, an increase in connection charge fee revenue, and a refund for prior year excise tax payments. Actual revenue came in right on budget for 2008.
- **Surface Water Management Fund** Surface Water fees are paid through property tax collection, which are primarily received in April and October. Actual 2008 revenue ended **3.3 percent ahead** of the same period last year, which is within a normal range of variability.
- **Solid Waste Fund** actual 2008 revenue ended **8.1 percent ahead** last year, which is higher than planned due to normal variability in billing collections. Actual revenue was slightly ahead of budget for 2008.

Resources by Fund	Year-to-Date Actual 12/31/2007	12/31/2008	% Change	Budget 2007	2008	% Change	% of Budget 2007	2008
General Gov't Operating:								
General Fund	53,205,151	52,601,566	-1.1%	53,555,451	53,895,913	0.6%	99.3%	97.6%
Other General Gov't Operating Funds	16,843,346	17,059,679	1.3%	16,339,450	16,562,562	1.4%	103.1%	103.0%
Total General Gov't Operating	**70,048,497**	**69,661,245**	**-0.6%**	**69,894,901**	**70,458,475**	**0.8%**	**100.2%**	**98.9%**
Utilities:								
Water/Sewer Operating Fund	17,290,724	17,841,773	3.2%	16,494,804	17,821,208	8.0%	104.8%	100.1%
Surface Water Management Fund	5,158,441	5,330,988	3.3%	5,233,189	5,274,145	0.8%	98.6%	101.1%
Solid Waste Fund	7,886,637	8,516,909	8.0%	7,909,347	8,365,262	5.8%	99.7%	101.8%
Total Utilities	**30,335,802**	**31,689,670**	**4.5%**	**29,637,340**	**31,460,615**	**6.2%**	**102.4%**	**100.7%**
Total All Operating Funds	**100,384,299**	**101,350,915**	**1.0%**	**99,532,241**	**101,919,090**	**2.4%**	**100.9%**	**99.4%**

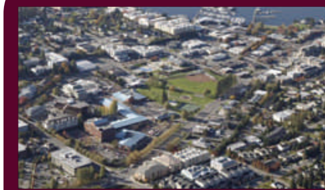
* Budgeted and actual revenues exclude resources forward and interfund transfers.

Summary of All Operating Funds: *Expenditures*

- **General Fund** actual expenditures were **98 percent** of budget primarily due to salary and benefit savings from position vacancies and under-expenditures in the supplies and professional services categories.
- **Other Operating Funds** actual expenditures were **95.4 percent** of budget primarily due to salary and benefit savings from position vacancies and under-expenditures in professional services. This is despite over-budget expenditures for vehicles that were originally budgeted in 2007, but purchased in 2008.
- **Water/Sewer Operating Fund** actual 2008 expenditures were **99.5 percent** of budget primarily due to higher personnel, water purchase, and METRO sewer costs and despite a significant decline in regional water connection charges.
- **Surface Water Management Fund** actual 2008 expenditures are **98.8 percent** of budget due to the significant progress made in 2008 on plans that were budgeted in 2007.
- **Solid Waste Fund** actual 2008 expenditures were **101.2 percent** of budget due to the normal variability of collection and timing of disposal contract billing payments. Actual expenditures are slightly over budget, but this is reflected in correspondingly higher revenue.

Expenditures by Fund	Year-to-Date Actual			Budget			% of Budget	
	12/31/2007	12/31/2008	% Change	2007	2008	% Change	2007	2008
General Gov't Operating:								
General Fund	50,604,654	55,050,769	8.8%	53,972,713	56,149,141	4.0%	93.8%	98.0%
Other General Gov't Operating Funds	14,234,313	15,082,568	6.0%	16,220,841	15,817,164	-2.5%	87.8%	95.4%
Total General Gov't Operating	**64,838,967**	**70,133,337**	**8.2%**	**70,193,554**	**71,966,305**	**2.5%**	**92.4%**	**97.5%**
Utilities:								
Water/Sewer Operating Fund	13,118,383	13,653,020	4.1%	13,626,789	13,718,748	0.7%	96.3%	99.5%
Surface Water Management Fund	2,544,984	2,663,623	4.7%	2,808,769	2,695,982	-4.0%	90.6%	98.8%
Solid Waste Fund	7,699,135	8,322,862	8.1%	7,858,709	8,221,762	4.6%	98.0%	101.2%
Total Utilities	**23,362,502**	**24,639,505**	**5.5%**	**24,294,267**	**24,636,492**	**1.4%**	**96.2%**	**100.0%**
Total All Operating Funds	**88,201,469**	**94,772,842**	**7.5%**	**94,487,821**	**96,602,797**	**2.2%**	**93.3%**	**98.1%**

* Budgeted and actual expenditures exclude working capital, operating reserves, capital reserves, and interfund transfers.



Despite the economic downturn, downtown is on the move.....

- **Kirkland Library** is closing in January 2009 for a 4,000 square foot expansion and is expected to be completed within a year.
- A new downtown **Transit Center** will have widened sidewalks, transit shelters, landscaping, and enhanced pedestrian crossings. Related projects include rebuilding the 3rd Street roadway, a new traffic signal and major utility improvements. The project is expected to be completed by the end of 2010.
- In conjunction with the library and transit center, the City is currently in the planning process for a major renovation of adjacent **Park Lane**, an important shopping and street connection between downtown and Peter Kirk Park.
- Private development activity continues, with a complete redevelopment of the **Park Place Shopping Center** in the works, which the developer hopes to commence by the end of 2009. This project will potentially provide 1.8 million square feet of office and retail space in the downtown area. Additionally, the redevelopment of the **Bank of America site** with a new mixed-use building has also been approved and is expected to start in 2009.

General Fund Revenue

- **Sales tax** revenue for 2008 was originally planned to increase slightly over 2007. The budget was adjusted downward in March because of disappointing performance early in the year. However, actual 2008 revenue experienced an even steeper decline than expected, **down 9.5 percent** compared to last year. A detailed analysis of General Fund **sales tax** revenue can be found starting on page 5.
- **Utility tax** actual revenue collection ended **6.4 percent ahead** of last year primarily due to growth in electricity and telephone tax revenue.
- **Other taxes** actual revenue ended **6.9 percent ahead** of last year primarily due to the one-time receipt of E-911 tax revenue for reimbursement of dispatch equipment and overtime, and despite a significant decline in leasehold excise tax due to a refund from prior years collections.
- **Business licenses and franchise fees** actual revenue ended **5.2 percent ahead** of last year due to franchise fee revenue. The **revenue generating regulatory license** fee ended **2.8 percent ahead** of last year. Variability of the timing of renewals from larger businesses can skew year-to-year comparisons.

Many significant General Fund revenue sources are economically sensitive, such as sales tax and development–related fees.

- **Other licenses and permits** are **down 27.7 percent** from last year due to one-time revenue received in 2007 for street use permits.
- The serious economic downturn experienced nationally and locally in 2008 is illustrated in **development-related fee** revenues, which collectively ended **down 24.1 percent** compared to last year. **Building/structural permits** 2008 revenue is **21.1 percent lower** than 2007. **Plan check** revenue is **12 percent below** 2007. **Planning fees** and **engineering services** revenue are **down 48.9 percent** and **18.3 percent** respectively.
- The significant increase in **Emergency Medical Services (EMS)** revenue reflects the voter-approved public safety levy effective in 2008.
- **Other charges for service** revenue **ended down 23.6 percent** compared to last year due to one-time revenue received last year for regional public safety dispatch planning and lower probation revenue.

General Fund 2008 revenues are $0.6 million lower than the same period in 2007 and $1.3 million under budget largely due to slumping sales tax and development-related revenue and despite strong utility tax revenue.

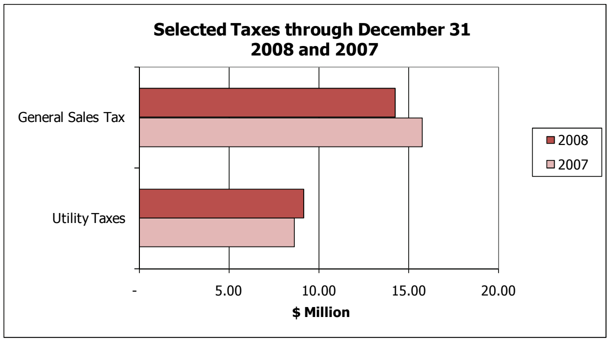
The General Fund is the largest of the General Government Operating funds. It is primarily tax supported and accounts for basic services such as public safety, parks and recreation, and community development.

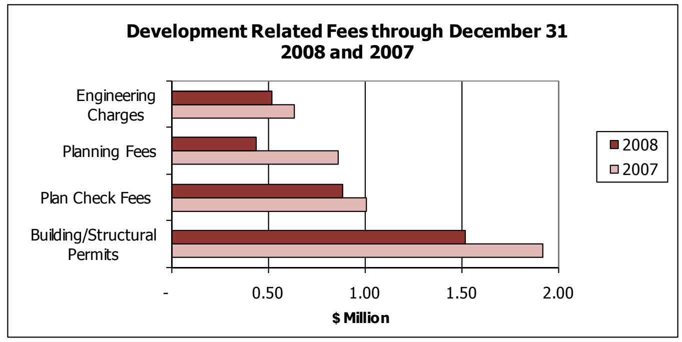
About 374 of the City's 470 regular employees are budgeted within this fund.

General Fund Resource Category	Year-to-Date Actual			Budget			% of Budget	
	12/31/2007	12/31/2008	% Change	2007	2008	% Change	2007	2008
Taxes:								
Retail Sales Tax: General	15,756,446	14,261,208	-9.5%	15,918,981	15,756,800	-1.0%	99.0%	90.5%
Retail Sales Tax: Criminal Justice	1,159,184	1,139,408	-1.7%	1,114,253	1,050,000	-5.8%	104.0%	108.5%
Property Tax	8,612,296	9,240,915	7.3%	8,790,086	9,037,710	2.8%	98.0%	102.2%
Utility Taxes	8,611,700	9,161,597	6.4%	8,723,683	8,546,130	-2.0%	98.7%	107.2%
Rev Generating Regulatory License	981,237	1,008,293	2.8%	936,671	990,000	5.7%	104.8%	101.8%
Other Taxes	534,792	571,934	6.9%	462,597	664,713	43.7%	115.6%	86.0%
Total Taxes	**35,655,655**	**35,383,355**	**-0.8%**	**35,946,271**	**36,045,353**	**0.3%**	**99.2%**	**98.2%**
Licenses & Permits:								
Building, Structural & Equipment Permits	1,920,557	1,515,209	-21.1%	2,078,436	2,163,450	4.1%	92.4%	70.0%
Business Licenses/Franchise Fees	1,470,393	1,546,913	5.2%	1,421,435	1,449,450	2.0%	103.4%	106.7%
Other Licenses & Permits	238,067	172,150	-27.7%	188,749	193,900	2.7%	126.1%	88.8%
Total Licenses & Permits	**3,629,017**	**3,234,272**	**-10.9%**	**3,688,620**	**3,806,800**	**3.2%**	**98.4%**	**85.0%**
Intergovernmental:								
Grants	195,460	290,914	48.8%	182,160	155,260	-14.8%	107.3%	187.4%
State Shared Revenues & Entitlements	636,521	709,705	11.5%	623,230	645,318	3.5%	102.1%	110.0%
Fire District #41	3,184,310	3,439,879	8.0%	3,184,310	3,487,428	N/A	100.0%	98.6%
EMS	512,252	793,023	54.8%	504,376	793,023	N/A	101.6%	100.0%
Other Intergovernmental Services	582,337	621,710	6.8%	589,478	439,609	-25.4%	98.8%	141.4%
Total Intergovernmental	**5,110,880**	**5,855,231**	**14.6%**	**5,083,554**	**5,520,638**	**8.6%**	**100.5%**	**106.1%**
Charges for Services:								
Internal Charges	3,377,529	3,536,860	4.7%	3,443,777	3,511,012	2.0%	98.1%	100.7%
Engineering Services	631,926	515,972	-18.3%	635,000	610,000	-3.9%	99.5%	84.6%
Plan Check Fee	1,004,419	883,729	-12.0%	958,760	900,000	-6.1%	104.8%	98.2%
Planning Fees	858,233	438,350	-48.9%	968,900	1,194,637	23.3%	88.6%	36.7%
Recreation	79,939	82,385	3.1%	79,516	83,000	4.4%	100.5%	99.3%
Other Charges for Services	904,453	690,566	-23.6%	880,191	688,323	-21.8%	102.8%	100.3%
Total Charges for Services	**6,856,499**	**6,147,862**	**-10.3%**	**6,966,144**	**6,986,972**	**0.3%**	**98.4%**	**88.0%**
Fines & Forfeits	1,360,604	1,414,371	4.0%	1,317,860	1,132,000	-14.1%	103.2%	124.9%
Miscellaneous	592,496	566,475	-4.4%	553,002	404,150	-26.9%	107.1%	140.2%
Total Revenues	**53,205,151**	**52,601,566**	**-1.1%**	**53,555,451**	**53,895,913**	**0.6%**	**99.3%**	**97.6%**
Other Financing Sources:			N/A			N/A		
Interfund Transfers	888,083	1,734,495	N/A	988,434	1,441,253	N/A	89.8%	120.3%
Total Other Financing Sources	**888,083**	**1,734,495**	**N/A**	**988,434**	**1,441,253**	**N/A**	**89.8%**	**120.3%**
Total Resources	**54,093,234**	**54,336,061**	**0.4%**	**54,543,885**	**55,337,166**	**1.5%**	**99.2%**	**98.2%**

* Budgeted and actual revenues exclude resources forward.

General Fund Revenue *continued*





General Fund Expenditures

General Fund Department Expenditures	Year-to-Date Actual 12/31/2007	12/31/2008	% Change	Budget 2007	2008	% Change	% of Budget 2007	2008
Non-Departmental	984,978	1,254,191	27.3%	1,126,152	1,391,813	23.6%	87.5%	90.1%
City Council	285,801	351,677	23.0%	316,392	362,034	14.4%	90.3%	97.1%
City Manager's Office	3,103,731	3,507,562	13.0%	3,419,542	3,784,425	10.7%	90.8%	92.7%
Human Resources	966,273	1,026,646	6.2%	1,039,649	1,122,706	8.0%	92.9%	91.4%
City Attorney's Office	868,030	958,704	10.4%	957,460	991,985	3.6%	90.7%	96.6%
Parks & Community Services	5,463,756	5,850,153	7.1%	5,889,784	6,059,645	2.9%	92.8%	96.5%
Public Works (Engineering)	3,433,723	3,418,006	-0.5%	3,643,248	3,578,878	-1.8%	94.2%	95.5%
Finance and Administration	3,147,281	3,355,677	6.6%	3,420,487	3,536,915	3.4%	92.0%	94.9%
Planning & Community Development	3,162,417	3,367,756	6.5%	4,105,866	3,381,197	-17.6%	77.0%	99.6%
Police	13,298,770	15,249,685	14.7%	14,236,955	15,019,785	5.5%	93.4%	101.5%
Fire & Building	15,889,894	16,710,712	5.2%	15,817,178	16,919,758	7.0%	100.5%	98.8%
Total Expenditures	**50,604,654**	**55,050,769**	**8.8%**	**53,972,713**	**56,149,141**	**4.0%**	**93.8%**	**98.0%**
Other Financing Uses:								
Interfund Transfers	730,233	1,506,971	106.4%	705,360	1,594,916	126.1%	103.5%	94.5%
Total Other Financing Uses	**730,233**	**1,506,971**	**106.4%**	**705,360**	**1,594,916**	**126.1%**	**103.5%**	**94.5%**
Total Expenditures & Other Uses	**51,334,887**	**56,557,740**	**115.2%**	**54,678,073**	**57,744,057**	**5.6%**	**93.9%**	**97.9%**

* Budgeted and actual expenditures exclude working capital, operating reserves, and capital reserves.

2008 expenditure budgets were higher than 2007 for most departments primarily due to higher personnel costs, including an unsettled labor contract from 2007 that settled in 2008. All departments but one were under budget largely due to salary savings and uncompleted projects. The only exception is Police, which is over budget in 2008 due to higher than expected jail costs; although the department ended the biennium within the biennial budget amount. In addition to this general trend, specific highlights and budget to actual comparisons by selected departments are listed below:

- Actual 2008 expenditures for **Non-Departmental** were **90.1 percent** of budget primarily due to lower than expected retiree medical costs and under-expenditure in professional services.
- Actual 2008 expenditures for the **City Council** were **97.1 percent** of budget primarily due to savings in Council travel, salaries and benefits.
- Actual 2008 expenditures for the **City Manager's Office** were **92.7 percent** of budget primarily due to personnel savings and under expenditure in professional services due to uncompleted projects that will be completed in 2009.
- Actual 2008 expenditures for the **City Attorney's Office** were **96.6 percent** of budget primarily due to personnel savings and despite slightly higher than expected legal services contract expenses.
- Actual 2008 expenditures for the **Parks & Community Services Department** were **96.6 percent** of budget primarily due to personnel savings and timing of human services contract payments, and de-

(Continued on page 5)

Compared to 2007, 2008 General Fund actual expenditures were 8.8 greater primarily due to higher personnel costs, settlement of a labor contract that included back-pay for 2007 in 2008, and timing of major projects.

spite higher than expected operating supplies and services costs resulting from severe weather and other unplanned events.

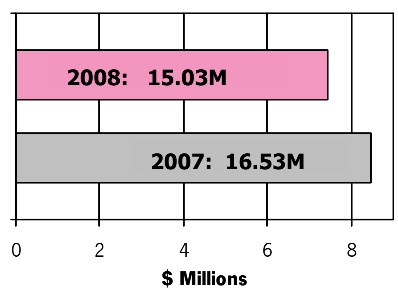
Severe December winter weather provided picturesque scenery, but challenges for City street and public safety crews

- Actual 2008 expenditures for the **Public Works Department** were **95.5 percent** of budget primarily due to position vacancies and under-expenditure in professional services.
- Actual 2008 expenditures for the **Finance and Administration Department** were **95.5 percent** of budget primarily due to salary and benefit savings, under-expenditure in election-related costs, printing, and professional services.
- Actual 2008 expenditures for the **Police Department** were **101.5 percent** of budget primarily due to higher than anticipated jail costs and the purchase in 2008 of equipment budgeted in 2007, and despite personnel savings and under-expenditure in professional services, travel and training, and repairs and maintenance.
- Actual 2008 expenditures for the **Fire & Building Department** were **98.8 percent** of budget primarily due to salary savings from purposely unfilled development positions and development professional services, and despite significant over-budget costs for fire suppression overtime.

Sales Tax Revenue Analysis

Total 2008 actual revenue ended down 9 percent compared to last year primarily due to significant softening in contracting revenue, as well as declining revenue in key retail sectors. The dramatic economic downturn experienced both nationally and locally is reflected in sales tax revenue performance for Kirkland. (See table on page 6).

Sales Tax Receipts through December 2008 and 2007



Review by business sectors:

- The **contracting** sector ended **11.1 percent down** compared to last year due to the completion of major projects and a general weakening in development activity.
- The **miscellaneous** sector ended **26.6 percent down** compared to last year primarily due to one-time revenue received in 2007. Factoring out identified one-time events, this sector is about 8.3 percent behind last year.
- **Auto/gas retail** ended **8.7 percent down** compared to last year due to disappointing performance by key retailers and the relocation of one retailer to Bellevue. The last few months of the year were especially dismal, reflecting the trends experienced nationally in this sector.
- **General merchandise/miscellaneous retail** ended **8.8 percent down** compared to last year due to disappointing performance by key retailers—possibly a sign of continued weakening consumer confidence.
- **Wholesale** ended **10.7 percent down** compared to last year primarily due to a reduction in development-related activity.
- The **communications** sector ended **16.5 percent down** compared to last year due to significant development activity in this sector last year and despite moderate growth in cellular phone services this year.
- **Other retail** ended **4.3 percent down** compared to last year due to the closure of two major retailers and despite the opening of a major new retailer.
- The **services** sector ended **3.2 percent down** compared to last year due to significant one-time development activity in 2007, the departure of a major bio-tech pharmaceutical research company, and despite the strength of the accommodations subsector. It should be noted that this sector is still experiencing development-related activity, just not consistently at the same level as last year.
- **Retail eating/drinking** is essentially flat; ending **0.7 percent down** compared to last year. This sector was relatively strong the first half of the year; faltering the second half.

Streamlined Sales Tax

Washington State implemented new local coding sales tax rules as of July 1, 2008 as a result of joining the national Streamlined Sales Tax Agreement. Any negative impact from this change is mitigated by the State of Washington. Kirkland received its first mitigation payment check of $75,000 in December. The calculations for these payments are still in the development stage, so it's unknown whether there will additional mitigation payments..

Neighboring Cities

Bellevue 2008 sales tax revenue is down 1.7 percent from 2007. Redmond 2008 sales tax revenue is down 16.6 percent from 2007.

City of Kirkland Actual Sales Tax Receipts

Business Sector Group	January - December 2007	January - December 2008	Dollar Change	Percent Change	Percent of Total 2007	Percent of Total 2008
Services	1,770,632	1,713,972	(56,660)	-3.2%	10.7%	11.4%
Contracting	3,010,436	2,677,270	(333,166)	-11.1%	18.2%	17.8%
Communications	618,560	516,339	(102,221)	-16.5%	3.7%	3.4%
Auto/Gas Retail	3,275,134	2,990,979	(284,155)	-8.7%	19.8%	19.9%
Gen Merch/Misc Retail	2,603,511	2,373,271	(230,240)	-8.8%	15.8%	15.8%
Retail Eating/Drinking	1,294,444	1,285,663	(8,781)	-0.7%	7.8%	8.6%
Other Retail	1,826,411	1,748,388	(78,023)	-4.3%	11.1%	11.6%
Wholesale	1,035,045	923,939	(111,106)	-10.7%	6.3%	6.1%
Miscellaneous	1,092,295	801,270	(291,025)	-26.6%	6.6%	5.4%
Total	**16,526,468**	**15,031,091**	**(1,495,377)**	**-9.0%**	**100.0%**	**100.0%**

Kirkland's sales tax base is comprised of a variety of businesses which are grouped and analyzed by business sector (according to NAICS, or "North American Industry Classification System"). Nine business sector groupings are used to compare 2007 and 2008 year-to-date sales tax receipts in the table to the left.

Month	Sales Tax Receipts 2007	Sales Tax Receipts 2008	Dollar Change	Percent Change
January	1,267,021	1,227,855	(39,166)	-3.1%
February	1,525,665	1,586,493	60,828	4.0%
March	1,154,890	1,112,704	(42,186)	-3.7%
April	1,604,395	1,085,739	(518,656)	-32.3%
May	1,496,755	1,367,777	(128,978)	-8.6%
June	1,422,662	1,073,094	(349,568)	-24.6%
July	1,428,250	1,253,751	(174,499)	-12.2%
August	1,253,921	1,388,993	135,072	10.8%
September	1,445,966	1,335,699	(110,267)	-7.6%
October	1,299,258	1,205,125	(94,133)	-7.2%
November	1,348,896	1,281,997	(66,899)	-5.0%
December	1,278,789	1,111,864	(166,925)	-13.1%
Total	**16,526,468**	**15,031,091**	**-1,495,377**	**-9.0%**

When analyzing monthly sales tax receipts, there are two items of special note: First, most businesses remit their sales tax collections to the Washington State Department of Revenue on a monthly basis. Small businesses only have to remit their sales tax collections either quarterly or annually, which can create anomalies when comparing the same month between two years. Second, for those businesses which remit sales tax monthly, there is a two month lag from the time that sales tax is collected to the time it is distributed to the City. For example, sales tax received by the City in December is for sales activity in October. Monthly sales tax receipts through December 2007 and 2008 are compared in the table to the left.

- **February 2008 experienced the only "real" positive monthly increase compared to the same month in the prior year since July 2007.**
- **Significant revenue from the I-405 interchange project was received in April 2007 and subtracted as an overpayment in August. Normalized, the comparison for April is changed to about a 22 percent decline and August to a 4.7 decline from the same months of the previous year.**
- **Adjustments between May and July receipts also skew comparisons. Normalizing for the adjustments, May is down 14.9 percent compared to May 2007 and June is down 18 percent compared to June 2007.**

Kirkland's sales tax base is further broken down by business district (according to geographic area), as well as "unassigned or no district" for small businesses and busi-

Totem Lake, which accounts for almost 31 percent of the total sales tax receipts, ended **7.5 percent down** compared to last year primarily due to slumping automotive/gas retail sales, the closure of two major retailers, and generally weak retail and finance/real estate activity. Sixty percent of this business district's revenue comes from the auto/gas retail and general merchandise/miscellaneous retail sectors.

NE 85th Street, which accounts for 15 percent of the total sales tax receipts, ended **10.5 percent down** compared to last year primarily due to the automotive/gas retail and general merchandise/miscellaneous retail. Almost 86 percent of this business district's revenue comes from these two business sectors.

Downtown, which accounts for over 7 percent of the total sales tax receipts, ended **2.3 percent up** compared to last year primarily due to moderately strong performance in the retail eating/drinking and accommodations sectors, which provide over 43 percent of this business district's revenue and despite declines in other retail, business services, and miscellaneous sectors (manufacturing).

Carillon Point & Yarrow Bay, which accounts for almost 3 percent of the total sales tax receipts, ended **16.2 percent down** compared to last year primarily due to poor performance from major software companies and despite positive performance in the accommodations sector. Almost 77 percent of this business district's revenue comes from business services, retail eating/drinking and hotels.

Houghton & Bridle Trails, which accounts for over 3 percent of the total sales tax receipts, ended **18.8 percent down** compared to last year almost entirely due to miscellaneous retail, which provides over 31 percent of these business districts' revenue.

Juanita, which accounts for 2 percent of the total sales tax receipts, ended **4 percent up** compared to last year primarily due personal services. A one-time recovery received in 2007 in the retail eating and drinking sector skews comparisons between the years. Factoring out the one-time 2007 receipt, this business district would be up about 8.5 percent. Retail eating/drinking and personal services provides over 47 percent of this business district's revenue.

it's important to point out that over 40 percent of the revenue received in 2008 is in the "unassigned or no district" category largely due to contracting revenue (which has declined compared to last year), and increasing revenue from Internet, catalog sales and other businesses located outside of the City.

City of Kirkland Sales Tax by Business District

Business District	Jan - Dec Receipts		Dollar Change	Percent Change	Percent of Total	
	2007	2008			2007	2008
Totem Lake	5,015,973	4,640,900	(375,073)	-7.5%	30.4%	30.9%
NE 85th St	2,523,696	2,258,993	(264,703)	-10.5%	15.3%	15.0%
Downtown	1,107,757	1,133,293	25,536	2.3%	6.7%	7.5%
Carillon Pt & Yarrow Bay	477,423	399,963	(77,460)	-16.2%	2.9%	2.7%
Houghton & Bridle Trails	627,886	509,994	(117,892)	-18.8%	3.8%	3.4%
Juanita	283,139	294,414	11,275	4.0%	1.7%	2.0%
Unassigned or No District:						
Contracting	3,010,436	2,677,754	(332,682)	-11.1%	18.2%	17.8%
Other	3,480,158	3,115,780	(364,378)	-10.5%	22.7%	22.7%
Total	**16,526,468**	**15,031,091**	**(1,495,377)**	**-9.0%**	**100.0%**	**100.0%**

Sales Tax Revenue Outlook Negative sales tax performance in 2008 demonstrates the volatility inherent in this revenue and as Kirkland's largest general government revenue source, it also illustrates the threat it poses to the City's ability to maintain services. The local economy is seeing the impact of the national economic problems and the outlook for 2009 is uncertain at best. The poor performance in the automotive/gas retail and general merchandise/miscellaneous retail sectors are concerning since these sectors represent the majority of the "ongoing" revenues in contrast with development activity, which is more one-time in nature. Additional risks include the opening of a Costco store in Redmond now expected in the first half of 2009 and the plan for a major automobile dealership to relocate their sales activities outside the City limits. On the bright side, there are some new large projects in the pipeline, such as the replacement of Lake Washington High School, the Bank of America project, the Fred Meyer store renovation, and continuing activity at and around Evergreen Hospital. Potential

OFFICE VACANCIES:

The Eastside vacancy rate is rising— 13 percent at the end of 2008 compared to 10.5 percent as of June. Kirkland's rate ended 2008 at 8.6 percent. Kirkland remains the most expensive sub-market according to CB Richard Ellis Real Estate Services. Global and regional economic conditions may prove challenging for the office market in 2009.

LODGING TAX REVENUE:

Lodging tax 2008 revenue is up 13.1 percent compared to the same period last year due to overall strong performance in the accommodations industry as well as the new hotel, which opened downtown in late 2007. Performance in 2009 may not be as robust since this sector is especially sensitive to economic conditions.

Economic Environment Update The global recession and financial crisis has finally hit the Puget Sound region. Regional employment and housing prices held up relatively well compared to the rest of the nation until the last few months of 2008. The slumping housing market, credit crunch, layoffs and reduced spending have slammed the region's economy in a way that wasn't predicted by economists earlier in the year.

King County's unemployment rate increased from 3.6 percent in January to 5.7 percent in December, which is still below the national and state rate of 7.1 percent. The number of jobs in the Puget Sound region dipped slightly since January and Washington State's chief economist Arun Raha expects a statewide job market contraction of 0.7 percent in 2009. However, the state's biggest private employers, Boeing and Microsoft, are expected to position Washington to beat the national curve in 2009 and be ready for a year-end rebound. Boeing has a solid backlog of about five years of plane orders. One caution: the vast majority of Boeing's customers are from foreign clients, so diminished global demand could be a risk. Technology jobs, anchored by Microsoft and Amazon, along with other private firms, are seen as relatively solid.

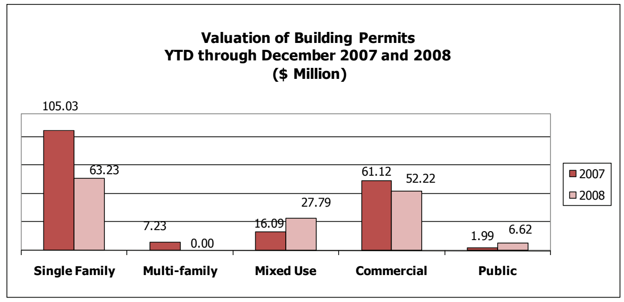
The Western Washington chapter of Purchasing Managers survey index stood at 32.4 in December, which the group considers "definitely indicating a recession." An index reading greater than 50 indicates a growing economy, while scores below suggest a shrinking economy. However, a Microsoft survey of small business owners conducted in December indicate that although worried, they expect their businesses to weather the current economic storm and that 2009 will be better than 2008.

In normal times, economists hedge that it is difficult to accurately predict future economic activity. After the recent financial implosion, which included the largest bank failure in history with Seattle-based Washington Mutual, it's virtually impossible. In addition to the national economy, the state and region is dependent on global activity; how well the rest of the world recovers will have a significant impact.

(Continued on page 8)

Economic Environment Update *continued*

Local **development activity** comparing 2008 to 2007 as measured by the valuation of City of Kirkland building permits is illustrated in the chart to the right. Activity has dropped considerably—especially in the single family and multi-family sectors. The only positive growth in 2008 is in the mixed-use category due to two large complexes under development. Commercial development was also relatively strong. Concerns about the slowing local real estate market and the credit crunch could have a significant impact on development activity in 2009.



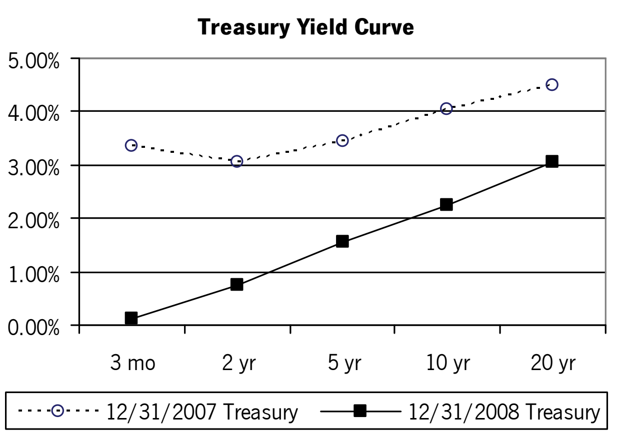
Pending sales of **new and existing single-family homes** in the Seattle area are down 35 percent in December 2008 compared with a year earlier. The median price of a single family home in 2008 was down 5.5 percent from 2007 ($429,950 compared to $455,000). Condominiums fared better, with median prices down 2.25 percent from the prior year ($280,000 compared to $286,438). However, the "*Emerging Trends in Real Estate® 2009 Report*" from the Urban Land Institute and Pricewaterhousecoopers singles out Seattle as the top real estate investment market to watch. Although tepid job growth is expected to dampen housing prices, the region is expected to stay above national averages.

Seattle metro CPI consistent with the national index, has been volatile throughout the year. Seattle peaked at 6.19 percent in June and August, but dropped to 1.1 percent in December. The national index peaked at 6.2 percent in July and dropped to a negative 0.5 percent in December. The 2008 average annual for Seattle is 4.5 percent. The June 2008 CPI is normally used to calculate City employee cost of living adjustments (COLA) for 2009. As a result, the 2009 COLA for most closed bargaining units in 2009 will be 6.19 percent, which is the highest adjustment in several years.

Investment Report

MARKET OVERVIEW

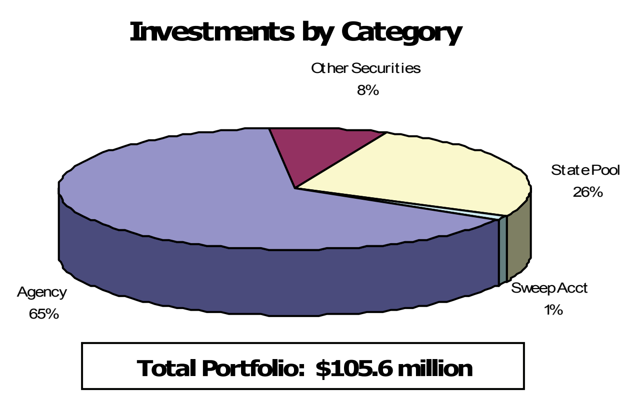
The market experienced unprecedented volatility in 2008 starting in the third quarter, continuing throughout the fourth quarter and into 2009. To help stabilize the markets, the Federal Government provided a tremendous supply of liquidity to the market. The Fed Funds rate dropped from 4.25 percent at the beginning of year to a range of 0.00 percent to 0.25 percent at the end of 2008. As can be seen in the accompanying graph, the treasury yield curve has reached new lows on the short end of the curve.



CITY PORTFOLIO

It is the policy of the City of Kirkland to invest public funds in a manner which provides the highest investment return with maximum security while meeting the City's daily cash flow requirements and conforming to all Washington state statutes governing the investment of public funds.

The primary objectives for the City of Kirkland's investment activities are: legality, safety, liquidity and yield. Additionally, the City diversifies its investments according to established maximum allowable exposure limits so that reliance on any one issuer will not place an undue financial burden on the City. The City's portfolio remained level in 2008. On December 31, 2008 Kirkland's portfolio balance was $105.6 million compared to $105.9 million on December 31, 2007.



Diversification

The City's current investment portfolio is composed of Government Agency bonds, State and Local Government bonds, the State Investment Pool and an overnight bank sweep account. Fannie Mae and Freddie Mac, two of the Government Sponsored Enterprises (GSEs), entered into conservatorship with the Federal Housing Finance Agency on September 7, 2008. This move, along with actions from the U.S. Treasury has enhanced the creditworthiness of these two GSEs. Additionally, on September 7, 2008, Standard & Poor's Ratings Services affirmed its long-term 'AAA' senior unsecured debt ratings on Fannie Mae and Freddie Mac based on the explicit government support under the terms of the conservatorship and the U.S. Treasury's establishment of a preferred stock purchase agreement. These moves help reinforce the Federal Governments support of these agencies.

2009 ECONOMIC OUTLOOK and INVESTMENT STRATEGY

The professional forecasters of the Federal Reserve Bank of Philadelphia now expect the first two quarters of 2009 to have negative growth of 5.2 percent in the first quarter and 1.8 percent in the second quarter. 2009 GDP growth is expected to be negative 2.0 percent. Core inflation for 2009 is expected to be 1.2 percent. The unemployment rate is expected to average 8.4 percent for 2009. The Fed Funds rate, currently at 0.00 to 0.25 percent is expected to stay at this level throughout 2009 and begin increasing by 2nd quarter 2010.

While investment yield opportunities are limited during this period of low interest rates, the portfolio duration will move closer to the target range as the currently owned securities mature and are called. Additionally, investments maturing in two years or less will be purchased in order to help bring the portfolio duration within target. Total investment income for 2009 is estimated to be $2.8 million.

Investment Report *continued*

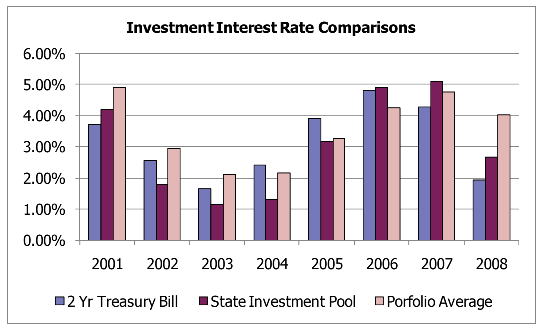
Liquidity

During 2008 the average maturity of the City's investment portfolio remained the same at 2.01 years. The 2 year treasury rate is used to establish the target duration of the City's portfolio as seen in the table below. With the 2 year treasury rate at 0.76% at year end, the target duration is under 1 year. The portfolio is currently above this as callable securities with longer maturities were purchased in the 4th quarter of 2008. These purchases were made to sustain higher earnings as interest rates declined. The portfolio duration will decrease as those securities are called. It is expected that they will be called since interest rates have declined significantly from the time that those securities were purchased.

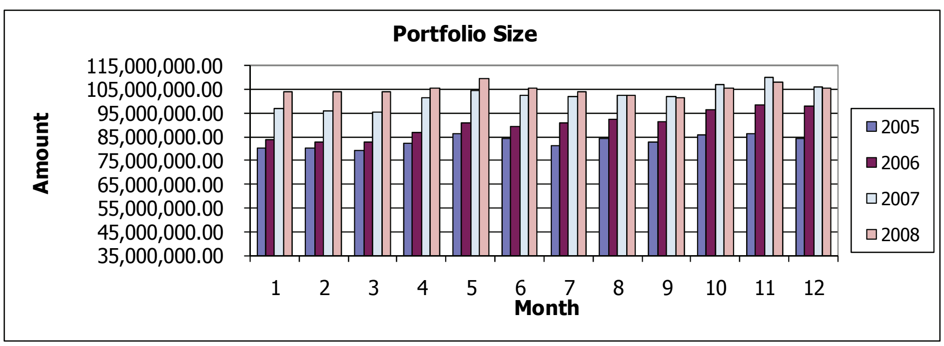
Benchmark Comparison	December 31, 2007	December 31, 2008
City Yield to Maturity (YTM)	4.89%	3.57%
City Annual Average YTM	4.75%	4.03%
City Year to Date Cash Yield	4.73%	4.36%
State Pool Average Yield	5.09%	2.68%
2 yr Treasury Note Avg YTM	4.27%	1.94%

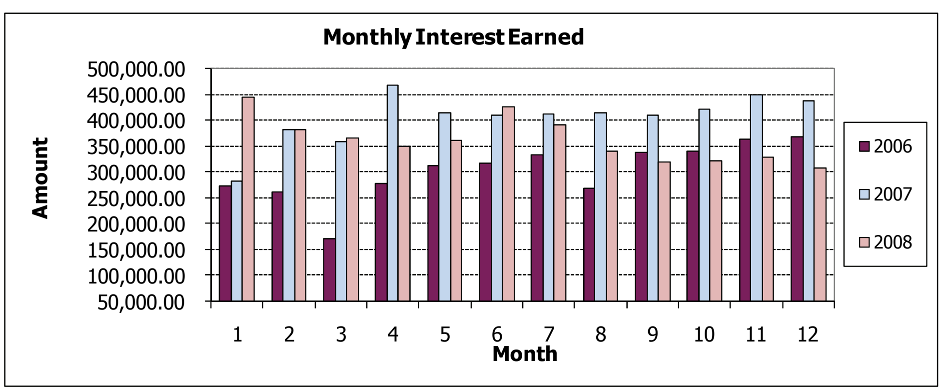
Yield

The City Portfolio yield to maturity decreased from 4.89% on December 31, 2007 to 3.57% on December 31, 2008. Through December 31, 2008, the City's annual average yield to maturity was 4.03%, which significantly outperformed the State Investment Pool annual average yield at 2.68% as well as the 2 Year Treasury note annual average for 2008 of 1.94%.



The City's practice of investing further out on the yield curve than the State Investment Pool results in earnings higher than the State Pool during declining interest rates and lower earnings than the State Pool during periods of rising interest rates. This can be seen in the adjacent graph.





Reserve Summary

General Operating Reserve

For the City's "Rainy Day" fund, the target is established by fiscal policy at five percent of the operating budget (excluding utility and internal service funds). Each year, the target amount will change proportional to the change in the operating budget. To maintain full funding, the increment between five percent of the previous year's budget and the current budget would be added or subtracted utilizing interest income and year-end transfers from the General Fund. It is a reserve to be used for unforeseen revenue losses and other temporary events. If the reserve is utilized by the City Council, the authorization should be accompanied by a plan for replenishing the reserve within a two to three year period.

Revenue Stabilization Reserve

The Revenue Stabilization Reserve was approved by Council in July 2003 and was created by segregating a portion of the General Operating Reserve. The purpose of this reserve is to provide an easy mechanism to tap reserves to address temporary revenue shortfalls resulting from temporary circumstances (e.g. economic cycles, weather-related fluctuations in revenue). Council set the target at ten percent of selected General Fund revenue sources which are subject to volatility (e.g. sales tax, development fees and utility taxes). The Revenue Stabilization Reserve may be used in its entirety; however, replenishing the reserve will constitute the first priority for use of year-end transfers from the General Fund.

Contingency Fund

The Contingency Fund was established pursuant to RCW 35A.33.145 to "provide monies with which to meet any municipal expense, the necessity or extent of which could not have been foreseen or reasonably evaluated at the time of adopting the annual budget." State law sets the maximum balance in the fund at $.375 per $1,000 of assessed valuation. This reserve would be used to address unforeseen expenditures (as opposed to revenue shortfalls addressed by the Revenue Stabilization Reserve). The fund can be replenished through interest earnings up to the maximum balance or through the year-end transfer if needed.

Reserves are an important indicator of the City's fiscal health. They effectively represent "savings accounts" that are established to meet unforeseen budgetary needs (general purpose reserves) or are otherwise dedicated to a specific purpose (special purpose reserves). The City's reserves are listed with their revised estimated balances at the end of the biennium in the table below:

Reserves	2007-08 Est End Balance	2007 Auth. Uses	2008 Auth. Uses	Revised 2007-08 End Balance
GENERAL PURPOSE RESERVES				
Contingency	3,193,826	365,936	250,339	2,577,551
General Capital Contingency	3,312,834		43,000	3,269,834
Park & Municipal Reserve:				
General Oper. Reserve (Rainy Day)	2,712,836			2,712,836
Revenue Stabilization Reserve	2,082,380			2,082,380
Building & Property Reserve	1,921,002	10,000		1,911,002
Council Special Projects Reserve	309,960	33,000	5,000	271,960
Total General Purpose Reserves	**13,532,838**	**408,936**	**298,339**	**12,825,563**
SPECIAL PURPOSE RESERVES				
Excise Tax Capital Improvement:				
REET 1	6,673,678	796,394		5,877,284
REET 2	6,067,898		35,000	6,032,898
Equipment Rental:				
Vehicle Reserve	5,899,578			5,899,578
Radio Reserve	36,000			36,000
Information Technology:				
PC Replacement Reserve	451,160			451,160
Major Systems Replacement Reserve	666,500			666,500
Facilities Maintenance:				
Operating Reserve	550,000			550,000
Facilities Sinking Fund	1,439,951			1,439,951
Impact Fees				
Roads	1,984,145			1,984,145
Parks	920,086			920,086
Park Bond Reserve	502,916			502,916
Cemetery Improvement	476,401			476,401
Off-Street Parking	29,564			29,564
Tour Dock	73,211			73,211
Street Improvement	1,121,498	161,100		960,398
Firefighter's Pension	1,359,860			1,359,860
Park & Municipal Reserve:				
Litigation Reserve	20,004			20,004
Labor Relations Reserve	51,255			51,255
Police Equipment Reserve	26,519			26,519
LEOFF 1 Police Reserve	625,754			625,754
Facilities Expansion Reserve	800,000			800,000
Development Services Reserve	1,290,831			1,290,831
Tree Ordinance	13,750			13,750
Donation Accounts	143,859			143,859
Revolving Accounts	148,606			148,606
Water/Sewer Operating Reserve	1,511,245		52,106	1,459,139
Water/Sewer Debt Service Reserve	820,155			820,155
Water/Sewer Capital Contingency	1,703,640	500,200	338,494	864,946
Water/Sewer Construction Reserve	8,738,358	835,000		7,903,358
Surface Water Operating Reserve	320,299			320,299
Surface Water Capital Contingency	876,760	202,000	341,200	333,560
Surface Water-Transp. Related Rsv	1,417,365	236,000	150,000	1,031,365
Surface Water Construction Reserve	2,136,422			2,136,422
Total Special Purpose Reserves	**48,897,268**	**2,730,694**	**916,800**	**45,249,774**
Grand Total	**62,430,106**	**3,139,630**	**1,215,139**	**58,075,337**

No Council Authorized Additions as of December 31, 2008.

Reserve Summary *continued*

USES AND ADDITIONS HIGHLIGHTS

RESERVE	AMOUNT	DESCRIPTION
2008 Council Authorized Uses		
Contingency Fund	$250,339	Funding to completely pay the outstanding amount of leasehold excise tax credit to the Washington State Department of Revenue. The balance was the result of a refund in 2008 of the overpayment over the last three years by Evergreen Hospital.
General Capital Contingency	$43,000	Additional funding for the NE 73rd Street Sidewalk project as a result of utilizing Low Impact Development (LID) approach - primarily added landscaping costs.
Council Special Projects Reserve	$5,000	Funding for 2008 membership dues to the Cascade Land Conservancy to become a Cascade Agenda Leadership City.
Real Estate Excise Tax (REET) 2 Reserve	$35,000	Funding for the Crosswalk upgrade program - NE 120th Place near the Casa Juanita Apartments.
Water/Sewer Operating Reserve	$39,106	Funding for the emergency repair of a watermain leak on NE 85th Street.
	$13,000	Funding for the Lake Washington sewer basin smoke testing.
Water/Sewer Capital Contingency	$180,000	Additional funding for the NE 73rd Street Sidewalk project for a watermain replacement and associated street overlay.
	$61,494	Additional funding for 2007 Water System Improvements
	$97,000	Additional funding for NE 80th Street Water and Sewer Main Replacement
Surface Water Capital Contingency	$158,500	Additional funding for the Juanita Creek Channel Enhancement project.
	$36,900	Additional funding for the NE 126th Street/94th Avenue NE Channel Restoration project.
	$145,800	Funding for Cochran Springs/Yarrow Point Flood Control
Surface Water Transportation Reserve	$150,000	Additional funding for 116th Avenue Nonmotorized Facilities Project-Surface Water Components
2008 Council Authorized Additions		
No Council Authorized Additions as of December 31, 2008		

Reserves	Revised 2007-08 End Balance	2007-08 Target	Over (Under) Target
GENERAL PURPOSE RESERVES			
Contingency	2,577,551	3,698,455	(1,120,904)
General Capital Contingency	3,269,834	5,822,280	(2,552,446)
Park & Municipal Reserve:			
General Oper. Reserve (Rainy Day)	2,712,836	3,134,779	(421,943)
Revenue Stabilization Reserve	2,082,380	2,143,422	(61,042)
Council Special Projects Reserve	271,960	250,000	21,960
General Purpose Reserves with Targets	**10,914,561**	**15,048,936**	**(4,134,375)**
SPECIAL PURPOSE RESERVES			
Excise Tax Capital Improvement:			
REET 1	5,877,284	1,435,000	4,442,284
REET 2	6,032,898	4,959,200	1,073,698
Information Technology:			
Major Systems Replacement Reserve	666,500	1,025,000	(358,500)
Firefighter's Pension	1,359,860	1,103,000	256,860
Park & Municipal Reserve:			
Litigation Reserve	20,004	50,000	(29,996)
LEOFF 1 Police Reserve	625,754	855,000	(229,246)
Development Services Reserve	1,290,831	1,290,831	0
Water/Sewer Operating Reserve	1,459,139	1,511,245	(52,106)
Water/Sewer Debt Service Reserve	820,155	820,155	0
Water/Sewer Capital Contingency	864,946	1,703,640	(838,694)
Surface Water Operating Reserve	320,299	320,299	0
Surface Water Capital Contingency	333,560	876,760	(543,200)
Special Purpose Reserves with Targets	**19,671,230**	**15,950,130**	**3,721,100**
Reserves without Targets	**27,489,546**	**n/a**	**n/a**
Total Reserves	**58,075,337**	**n/a**	**n/a**

The summary in the section above details all Council authorized uses and additions to each reserve through December 2008.

The table to the left compares the revised ending balance to the targets established in the budget process for those reserves with targets.

city of kirkland washington

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- Michael Olson, Deputy Director of Finance & Administration
- Sandi Hines, Financial Planning Manager
- Sri Krishnan, Senior Financial Analyst
- Neil Kruse, Budget Analyst

www.ci.kirkland.wa.us

The Financial Management Report (FMR) is a high-level status report on the City's financial condition that is produced quarterly.

- It provides a **summary budget to actual comparison** for year-to-date revenues and expenditures for all operating funds. The report also compares this year's actual revenue and expenditure performance to the prior year.
- The **Sales Tax Revenue Analysis** report takes a closer look at the City's largest and most economically sensitive revenue source.
- **Economic environment** information provides a brief outlook at the key economic indicators for the Eastside and Kirkland such as office vacancies, residential housing prices/sales, development activity, inflation and unemployment.
- The **Investment Summary** report includes a brief market overview, a snapshot of the City's investment portfolio, and the City's year-to-date investment performance.
- The **Reserve Summary** report highlights the uses of and additions to the City's reserves in the current year as well as the projected ending reserve balance relative to each reserve's target amount.

***Economic Environment Update References**:*

- Clay Holtzman, *Washington's economy offers few reasons for optimism,* Puget Sound Business Journal, December 26, 2008
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- *Microsoft survey says entrepreneurs optimistic about 2009,* Puget Sound Business Journal, January 14, 2009
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- CB Richard Ellis Real Estate Services, Market View Puget Sound, Fourth Quarter 2008
- Washington State Employment Security Department
- Washington State Department of Revenue
- Washington State Department of Labor & Industries
- U.S. Bureau of Labor Statistics
- City of Kirkland Building Division
- City of Kirkland Finance Department